INFORMED BUDGETEER

WHO'S THE BIG SPENDER HERE?

- With all the recent discussion of education funding and the new education proposals in President Clinton's FY 1998 budget, the *Bulletin* thought it would be helpful to take a look at the sources of education funds.

- As the table below shows, state and local governments are the largest contributors of elementary and secondary funds at 41.3% and 41.7% respectively. Federal funds account for only 6.6% of total expenditures in this category. The story is similar in post secondary funding where the federal contribution is 12.1%.

TOTAL EXPENDITURES FOR EDUCATION IN US[1]
($ in Billions)

Source of Funds by Level	1995-1996 Dollars	1995-1996 Percent	1996 -1997[2] Dollars	1996 -1997[2] Percent
Elementary & Secondary				
Federal[3]	21.1	6.6	22.2	6.6
State	131.6	41.3	139.2	41.3
Local	133.1	41.7	140.5	41.7
All Other	33.0	10.3	34.9	10.4
Subtotal	318.8	100.0	336.8	100.0
Postsecondary				
Federal[3]	25.8	12.3	26.6	12.1
State	47.7	22.8	50.4	22.9
Local	5.4	2.6	5.6	2.6
All Other[4]	130.4	62.3	137.1	62.4
Subtotal	209.3	100.0	219.7	100.0
All Levels				
Federal[3]	46.9	8.9	48.8	8.8
State	179.4	34.0	189.6	34.1
Local	138.4	26.2	146.1	26.3
All Other[4]	163.4	30.9	172.0	30.9
Total, All Levels	528.2	100.0	556.5	100.0

SOURCE: U.S. Department of Education, FY 1998 Budget Summary and Background Information.
NOTE:Details may not add to totals becasue of rounding.
[1]Data revised from previously published figures.
[2]Projected
[3]Includes expenditures of all Federal agencies
[4]Federally supported student aid that goes to higher education institutions through students' tuition is shown under "All Other" rather than "Federal".

WHAT HAPPENED TO MEDICAID SPENDING IN 1996?

- Medicaid spending grew only 3.3 percent in 1996, the lowest growth rate since 1982, and far below the trend of the late 1980's and early 1990's, when Medicaid spending exploded. Between 1985 and 1995, Medicaid spending nearly quadrupled, from $22.7 billion in 1985 to $89.1 billion in 1995.

- The Chairmen of the House and Senate Budget Committees asked GAO to examine the lower Medicaid spending growth in 1996 and provide some explanation and analysis.

- In response to this request, GAO has looked carefully at state level Medicaid data and provided the following preliminary information, which will be contained in forthcoming Congressional testimony and a report to the Budget Committee Chairmen.

- Overall, GAO found that 10 states experienced large decreases in their Medicaid rates of growth, 36 states (representing 80 percent of Medicaid spending) experienced moderate decreases or minimal changes, and 5 states experienced increases in their rates of growth (although, one of the 5, New Hampshire, grew only 1 percent in 1996 after a 22 percent decline in 1995).

- For some states, the constraints placed by Congress on Medicaid disproportionate share hospital (DSH) payments in 1991 and 1993 have forced major reductions in state and federal spending. In Louisiana, for instance, Medicaid DSH payments dropped from $919 million in 1995 to $675 million in 1996, a 27% drop. Louisiana's overall Medicaid spending fell nearly 16% in 1996 .

- One state -- Colorado -- shifted substantial Medicaid spending from 1996 into 1995, anticipating that such a shift would have been beneficial if Medicaid had been converted into block grants, as proposed during the 104th Congress. As a result, Colorado's Medicaid spending fell nearly 5 percent in 1996.

- GAO also found that states with large Medicaid waiver programs expanded eligibility significantly in 1994 and 1995, but, by 1996, such expansions stopped, and in some cases were slightly reversed to hold down costs.

  - In Tennessee, Medicaid spending grew nearly 22 percent in 1995, but less than 1 percent in 1996.

  - In Florida, spending grew 22 percent in 1995 but declined over 4 percent in 1996.

  - In Oregon, spending grew over 38 percent in 1995 but less than 5 percent in 1996.

- Other states indicated to GAO that lower medical price inflation has allowed them to curtail hospital and nursing home payment rates with less fear that such restraint will be overturned by the Boren amendment, which requires state Medicaid programs to make reasonable and adequate payments to these institutions for services.

- Finally, GAO cites the generally strong economic situation as an additional factor in holding down Medicaid eligibility in 1996.

- In conclusion, GAO stated that Medicaid growth may have moderated somewhat due to increasing use of managed care and the general slowdown in medical price inflation, but there were several unique factors in the 1996 growth rate that are unlikely to be repeated. As a result, Medicaid spending growth in 1997 and beyond is likely to be much higher than the 1996 growth rate.

LOW AND HIGH MEDICAID SPENDING GROWTH RATES
(Average Annual Growth Rate by %)*

	1994 -1996
Low Growth Rate States:	
New Hampshire	-11.1
Louisiana	-7.8
West Virginia	-2.5
District of Columbia	-0.9
Rhode Island	2.9
High Growth Rate States:	
Delaware	22.0
Hawaii	21.2
Oregon	20.1
Nevada	18.2
New Mexico	13.2

*Federal outlays only.

BUDGET 101: MANDATORY VS. DISCRETIONARY

- The President's budget proposes to spend up to $60 billion between now and 2002 for a number of new programs ranging from entitlements such as Medicare ($15 billion) and Medicaid benefits for children($5 billion) to other mandatory programs such as school construction and other education benefits ($6.2 billion).

- This new spending will NOT be subject to the annual appropriations process. Nonetheless the administration insists that most of these new programs are not entitlements (i.e. mandatory) because the spending will be subject to a "cap".

- Capped or not, once a program escapes the scrutiny of the appropriations process, it is extremely difficult to control the amount of money spent. A brief review of mandatory spending (a.k.a. entitlements) and discretionary spending (appropriations) illustrates the folly of creating new mandatory spending as part of an effort to balance the budget.

- *Mandatory (or direct) spending* generally includes all spending that is made pursuant to laws other than appropriations laws. Its fundamental characteristic is the lack of annual discretion to establish spending levels. Instead, it usually involves a binding legal obligation by the government to provide funding for an individual, program, or activity.

- *Entitlements* are a subset of mandatory spending and represent the largest component of such spending. Most entitlement spending is pursuant to laws that provide all eligible individuals with financial assistance or other benefit based upon some formula or criteria set out in such law. Unless the underlying law establishing the entitlement is modified, eligible individuals retain a legal right to benefits, regardless of the cost.

- In contrast, *discretionary spending* refers to those programs that are subject to annual funding decisions in the *appropriations* process. If Congress decides to lower funding for a program of this type, it can simply reduce the amount when the annual appropriation bill is being considered.

- Unlike entitlement spending, the underlying authorization need not be amended in order to control spending. Traditionally, discretionary spending has been the most controllable area of the federal budget. Both the Budget Enforcement Act (BEA) and recent Congressional Budget Resolutions have established overall limits on discretionary spending and enforced these limits through supermajority votes.

- The President's budget proposes to sunset a number of his mandatory spending programs by 2002 in order to reach balance. However, the BEA stipulates that the baseline for mandatory programs which exceed $50 million annually is assumed to continue even if the law provides for a sunset. Therefore, if the President's proposals become law, the baseline next year would assume these programs continue, notwithstanding Congress or the President's intent to the contrary.

- This means there is no cost relative to the baseline for continuing these programs. Past experience, the nature of these programs, and the budgetary procedures, taken together, virtually guarantee that once a mandatory program is started, there is little to encourage its termination and thus its spending will continue to grow unabated.

CAPITAL BUDGET COMMISSION = BBA VOTE?

- On February 25, the President announced the formation of a "bi-partisan", eleven member Capital Budget Commission to report to the President on a capital budget. The Washington Post reported that the commission was created to give Senator Torricelli a reason to vote against the balanced budget amendment (BBA) to the Constitution. Senator Torricelli announced his opposition to the BBA on February 26.

- The President appointed Jon Corzine and Kathleen Brown as Co-Chairs of the Commission. He called on the Commission to report to the President's National Economic Council by March 15, 1998. The Commission will adopt its report by a majority vote. The President directed the commission to review private sector and other governmental entities capital budgeting practices, the appropriate definition of capital, the role of depreciation, and the effect of a capital budget on choices between capital and other items in meeting public objectives.

- A federal capital budget has a number of serious flaws. It would weaken budgetary discipline by providing either an exemption or special treatment for capital outlays. A capital budget raises difficult definitional issues as to what constitutes "capital". The President directed his commission to examine very broad categories of investment including "investments in future and retired workers, capital to increase productivity, and capital to enhance the quality of life". Such a definition could be used to cover any federal program!

- Finally, to the extent a capital budget is used to justify higher borrowing for capital items, this additional borrowing must be diverted from private investment. Unless the Federal government can exceed the private sector's return from this investment, additional borrowing to finance federal investments will have no net positive effect on total investment in the economy. Since the evidence suggests that the private sector generates a much greater return from investment than the federal government, additional federal borrowing could actually reduce total investment in the economy.

- **The President's own budget provided a thorough analysis of capital budgeting and the problems it poses.** See chapter 6 of the Analytical Perspectives volume in the President's FY 1998 budget.

ECONOMICS

HIGHER INTEREST RATES AHEAD

- In Humphrey-Hawkins testimony last week, Chairman Greenspan warned that the Federal Reserve may soon need to make a preemptive strike against inflation. Although inflation is subdued at present, he stressed that the Fed must focus on the risks of future inflation given the roughly one year lag between policy action and economic impact. Tight labor markets and asset inflation are two main sources of inflation concern.

- Although worker insecurity has been holding inflation down recently, Chairman Greenspan said there are signs that such insecurity is ebbing. He referenced the January employment report which showed a rise in the number of voluntary job leavers, signifying greater worker confidence.

- Indeed, wage pressures are already being seen. Average hourly earnings rose 3.8% in January 1997 on a year over year basis, up from just 2.8% in January 1996. Further wage gains are likely going forward. With productivity unlikely to keep pace, this is an inflation concern.

- The FOMC next meets on March 25, with most economists now bracing for a 25 basis point interest rate hike. Such a move should prompt renewed backup in Treasury yields, making both CBO's and OMB's interest rate projections look too optimistic.

- The Federal Reserve also laid out its forecasts for growth and inflation in 1997 in its Monetary Report to Congress. It expects real GDP growth of 2.0 to 2.25 percent in 1997, with CPI rising between 2.75 to 3.0 percent. Both CBO's GDP growth and CPI forecasts are within the Fed's range. OMB's GDP forecast is also within range, however, they are below the Fed's range on expected CPI growth.

CALENDAR

March 5, 1997: Senate Budget Committee Hearing, Congressional Budget Office Analysis of President Clinton's FY 1998 Budget. Witness appearing before the committee will be CBO Director June O'Neill. Dirksen 608; 10:30 am.

March 12, 1997: Senate Budget Committee Hearing, Governor's (tentative)